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DOW THEORY LETTERS, INC.

"The Market as Interpreted under the Dow Theory"

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MYSTERIES NOT YET SOLVED: The professional speculator's "tool" is his margin account. Just as the public tends to deal in odd-lots for cash, the professional tends to deal in even lots on margin.

The accompanying chart is a record of broker's loans during the 1920's and up to 1931. The chart dramatically illustrates the fact that in 1929 broker's loans on the N. Y. S. E. advanced to the highest levels in history (toward the end of 1929 broker's loans rose above the $8 billion mark). During the ensuing three-year collapse the market systematically slaughtered the margin speculators. How do we know? The record speaks for itself. By 1932 broker's loans had dropped below $1 billion -- and the market was back on a cash basis.

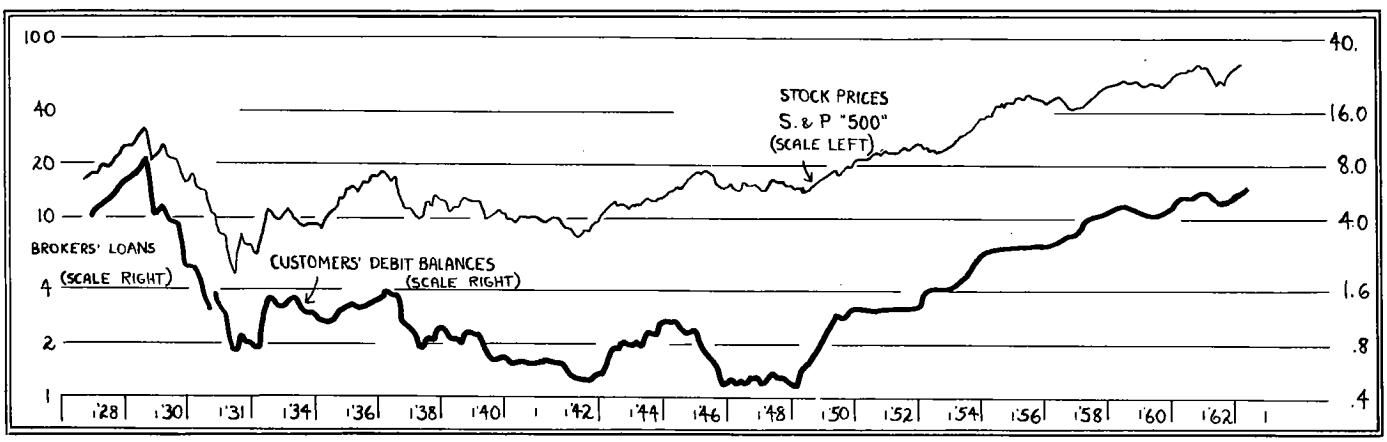
In 1931 the Exchange began issuing figures on all debit balances and this, of course, represents the actual total of margin outstanding in all customers' accounts.

The chart shows that from a low in 1932, margin accounts rose to a peak in 1937 (during the 1932-37 bull market). The long series of saw-tooth declines in the market following the 1937 top terminated in 1942. That year saw a low in margin accounts, and once more it could be said that the market was back on a cash basis. The 1942-46 bull market attracted margin accounts again, and debit balances rose to a peak in early 1945. Following the 1946 crash, margin accounts shrank again, dropping to a 17-year low in 1949 (lowest since 1932). Thus, the year 1949 began with a market devoid of any speculative interest. Cash was the word on Wall Street at the beginning of history's greatest bull market.

The fantastic thing about the period since the 1962 crash is that debit balances have now risen to the highest level ($4. 7 billion) since 1929. Evidently the 1962 crash did not act like crashes of the past in that it did not discourage the margin speculators. On the contrary, the fact that customers' debits are now at new highs suggests that professionals expect a still higher market. Or why else, we ask, would they assume their greatest margin position in a generation?

But in order to "unload" this huge speculative position, the margined sector of the market will need someone to sell to. Who will this "someone" be? Traditionally, it is the public, the same public who (the textbooks tell us) is prone to become increasingly bullish as an advance gets nearer and nearer to its final top.

But here another mystery stares us in the face. The second chart is from Mr. Garfield Drew's weekly Odd Lot Studies (50 Congress Street, Boston, Massachusetts). This study is a twelve-year history of odd-lot activity as a percentage of total N. Y. S. E. trading. Over the years it seems that the market has become increasingly institutional and this means that over a long period of time there has been a gradual diminution in the odd-lot percentage. Nevertheless, in the past, important low points in the odd-lot percentage of trading have corresponded with low points in the market. It is therefore most amazing to note that the odd-lot percentage is now at the lowest point since these records were first tabulated (Mr. Drew has taken the record back to 1920).



In other words, public participation in the market (as a percentage of total trading) is now at its lowest ebb in history. Thus we have an incredible situation in which the margin traders (who tend to be professionals) have assumed their biggest position in memory while the odd-lotters (who tend to be amateurs) are showing less interest in the market than at any time in history. Logically, this "should be" the formula for a booming market.

Why? The "textbook answer" runs as follows: "The professionals tend to be right, and the public tends to be wrong. If this is true, then future events will produce a background conducive to a booming market. At that time, the professionals will distribute their stocks to an increasingly bullish public, a public which will be as interested in the market then as they are disinterested today".

A second (but less pleasant) question: "Suppose the market starts down with the public unwilling (as they now are) to buy, and with the professionals holding the biggest chunk of margined stocks in a generation?" My answer: Such a situation could be dangerous -- the more so since we know that the professionals tend to get quickly with the trend. If the market now starts dropping and the professionals begin dumping their margined stocks, we could witness a dramatic decline, a decline which would add another chapter to one of the most unusual periods in market history.

CONCLUSION: The general picture as presented in this study is the one major bullish argument that this writer can apply to the current market. Historically and logically, rising debit balances and an extremely low odd-lot trading ratio should be followed by higher prices. For this reason, the writer believes that there is a definite case for assuming trading positions as soon as there is evidence to suggest that the current weakness is over and the next advance is about to begin.